

ANALYSIS OF AMENDED BILL

Author: Migden Analyst: Gail Hall Bill Number: SB 1827
Related Bills: See Legislative History Telephone: 845-6111 Amended Date: April 17, 2006
Attorney: Patrick Kusiak Sponsor: _____

SUBJECT:	Filing Status/Domestic Partners
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SUMMARY

This bill would require registered domestic partners to file personal income tax returns as either: (1) married filing joint, or (2) married filing separate.

SUMMARY OF AMENDMENTS

The April 17, 2006, amendments removed the provisions of the bill as introduced and added provisions that would provide registered domestic partners the same filing status rights as married persons.

PURPOSE OF THE BILL

According to the author's staff, the purpose of this bill is to eliminate discrimination by giving domestic partners the same filing status rights and burdens as married persons.

EFFECTIVE/OPERATIVE DATE

This bill would be effective on January 1, 2007, and operative as of that date.

POSITION

Pending.

ANALYSISFEDERAL/STATE LAWFederal Law

There are five different filing status choices for federal tax purposes. The appropriate filing status to select is based on the following rules:

1. An individual may choose the filing status "married filing jointly" if any of the following apply:

Board Position:

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Department Director

S. Stanislaus

Date

4/25/06

- An individual is married at the end of the taxable year, even if that individual did not live with their spouse at the end of the year,
 - An individual whose spouse died during the taxable year, and the individual did not remarry during that same taxable year,
 - An individual was married at the end of the taxable year and the spouse died in the next taxable year but before the tax return is filed.
2. An individual may choose the filing status “married filing separately” if the individual is married and chooses to file a separate tax return from the spouse. Each spouse reports on separate returns half of the couple’s community income and the total amount of the spouse’s separate income. Generally, an individual choosing this filing status will pay more tax.
 3. An individual may choose the filing status “head of household” if the individual is unmarried at the end of the tax year (or treated as unmarried) and provides a home for certain individuals for more than half of the tax year.
 4. An individual shall choose the filing status “single” if the individual was any of the following:
 - Never married,
 - Legally separated according to state law, under a decree of divorce or separate maintenance, or
 - Widowed before the beginning of the tax year and did not marry during the tax year.
 5. An individual may choose the filing status “qualifying widow(er) with dependent child” if all of the following apply:
 - The spouse died in either of the prior two taxable years,
 - The widow(er) has a child or stepchild whom is claimed as a dependent,
 - The child lived with the widow(er) for all of the taxable year, except for temporary absences for special circumstances,
 - The widow(er) paid over half the cost of keeping up the home, and
 - The widow(er) could have filed a joint return with the spouse in the year of death.

For federal tax purposes, registered domestic partners only have the filing status choices of “single” or “head of household.”

State Law

Current Law requires an individual to use the same filing status as that used on the federal income tax return for the same taxable year; therefore, registered domestic partners only have the filing status choices of “single” or “head of household” for state purposes.

Current law, as of January 1, 2005, does apply the same community property rules to domestic partners that are applied to married persons in the state. However, current state law also provides that earned income will not be treated as community property for state income tax purposes.

THIS BILL

Under state income tax law, this bill would require registered domestic partners to file a personal income tax return jointly or separately by applying the standards applicable to married couples under federal income tax law. In addition, this bill would provide a rule to determine the application of limits based on adjusted gross income for domestic partners by combining the amounts reflected as adjusted gross income on the federal income tax return of each domestic partner. In addition, this bill would revise existing provisions of law to treat registered domestic partners as married persons for purposes of filing status as follows:

- Domestic partners may file separate returns for any taxable year where a joint return has already been filed after the original filing period to file a return has expired.
- No joint return can be made if the domestic partners have different taxable years, subject to exception.
- Extend to registered domestic partners the same rules with respect to filing status that are applicable in the event of the death of one or both spouses.

IMPLEMENTATION CONSIDERATIONS

The department uses automated systems to compare taxpayer return information to files received from other state and federal agencies, including the Internal Revenue Service (IRS). These automated systems search through IRS records by Social Security Number and name and compares information on the taxpayer's federal income tax return to the information on the California income tax return. Current law generally requires the filing status of the taxpayer for the state tax return to be the same filing status as on the federal return; the information systems have the ability to verify joint returns based on the primary taxpayer's information. Domestic partners are required to file separate federal income tax returns and this bill would allow domestic partners to file a joint state income tax return; the department anticipates a significant delay in the ability of the automated systems to compare taxpayer information. The systems would be required to process the federal information more than once as the systems search for the primary taxpayer and the secondary taxpayer individually because each taxpayer would have a separate return at the federal level. The systems would need additional programming and testing prior to being operational.

TECHNICAL CONSIDERATIONS

1. If married persons file a tax return using the filing status "married filing jointly," a subsequent amended return changing the filing status to "married filing separately" is not allowed except for: 1) an active member of the armed forces or auxiliary branch, or 2) a nonresident for the entire taxable year who had no income from a California source. If the author would like this exception to apply to registered domestic partners, the attached Amendment 1 and Amendment 1A is necessary.

2. The provisions of this bill are conflicting with Section 297.5 of the Family Code that specifically provides domestic partners shall use the same filing status as used on their federal tax returns. It is recommended the author make the necessary amendments to the Family Code. (See attached Amendment 2.)
3. The provisions of the bill provide that registered domestic partners may either file a joint return or a separate return with the filing status married filing separately. To ensure that domestic partners interpret the proposed law to mean this bill would require domestic partners to file a joint return or separate return, it is recommended “may” be replaced with “shall.” (See attached Amendment 3.)

LEGISLATIVE HISTORY

AB 205 (Goldberg, Stats. 2003, Ch. 421) as introduced on January 28, 2003, would have allowed domestic partners to file personal income tax returns as either: (1) married filing joint, or (2) married filing separate. In addition, the bill as chaptered made changes to various California laws regarding domestic partners, including the creation of community property rights. It also added language that required the same filing status on a state income tax return as used on the federal income tax return and provided that earned income is not community property for state income tax purposes. The August 18, 2003, amendments to the bill removed the provisions of the bill that would have allowed domestic partners to file personal income tax returns as either: (1) married filing joint, or (2) married filing separate.

AB 25 (Migden, Stats. 2001, Ch. 893) allowed several existing taxpayer benefits for medical expenses and health insurance benefits to include a taxpayer's domestic partner and a domestic partner's dependents.

OTHER STATES' INFORMATION

The states surveyed include *Florida, Illinois, Massachusetts, Michigan, Minnesota, and New York*. These states were selected due to their similarities to California's economy, business entity types, and tax laws. These states have no provisions allowing domestic partners to file tax returns as married filing joint or married filing separate, except for *Massachusetts*.

For tax periods ending on or after May 16, 2004, *Massachusetts* recognizes the right of same-sex couples to be married. As a consequence, same-sex spouses that marry shall file *Massachusetts* income tax returns as married filing joint or married filing separate. *Massachusetts* is not a community property state.

FISCAL IMPACT

As discussed above under “Implementation Considerations,” implementing this bill would require some changes to existing tax forms and instructions and information systems, which could be accomplished during the normal annual update.

The department anticipates customer service contacts from taxpayers seeking clarification of the filing requirements. Further, the automated systems that compare federal and state tax information

for audit purposes would need additional programming and testing. As a result, the department would experience delays when the automated systems compare federal and state information because the systems would need to search the records individually to match both domestic partners. Departmental costs cannot be determined until implementation concerns have been resolved, but are anticipated to be significant.

ECONOMIC IMPACT

Revenue Estimate

Based on data and assumptions discussed below, the Personal Income Tax revenue loss from this bill would be as follows:

Estimated Revenue Impact of SB 1827 Effective On Or After January 1, 2007 Enactment Assumed After June 30, 2006 (\$ Millions)			
	2007-08	2008-09	2009-10
Income tax loss	-\$8	-\$9	-\$10

This estimate does not consider the possible changes in employment, personal income, or gross state product that could result from this measure.

Revenue Discussion

Registered Domestic Partnerships include same-sex partnerships, and opposite-sex partnerships in which one or both partners are age 62 or older and receiving Social Security benefits. According to the Secretary of State, there were 38,155 RDPs in California as of April 2006. It is estimated that by December 2007, the total number of RDPs would be 40,950.

Census data was used to calculate average income changes because data maintained by the Secretary of State is limited to the names and addresses of the registered domestic partners and does not include the necessary tax related information needed to calculate a revenue estimate. According to the Census 2000, California has over 90,000 same-sex partner households. If this bill were to become law, the tax liability change for each of these same-sex partners was approximated by using a random sample of these Census data records that included reported incomes and dependents for each partner. Households with tax liability reductions made up 59% of the total households and averaged \$473. Households with tax liability increases made up 12% of the total and averaged \$755. The remainder (29%) had little or no tax liability change. The average tax liability reductions and increases based on Census data were applied to the projected number of Registered Domestic Partnerships (RDP).

The revenue loss for the 2007-08 fiscal year was calculated as follows: (The final impact was rounded to -\$8 million dollars.)

$40,950 \text{ (RDPs)} \times 59\% \text{ (\%RDP with tax reduction)} \times \$473 \text{ (avg. tax reduction)} = -\11.5 million

$$\begin{aligned} 40,950 \text{ (RDPs)} \times 12\% \text{ (\%RDP with tax increase)} \times \$755 \text{ (avg. tax increase)} &= \$ 3.7 \text{ million} \\ &= -\$ 7.8 \text{ million} \end{aligned}$$

An additional 5% growth rate was applied to 2008-09 and 2009-10 to account for the incentive effect.

The revenue estimate assumes that the financial characteristics of the sample of same-sex households is representative of the population of registered domestic partners in California.

LEGISLATIVE STAFF CONTACT

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FRANCHISE TAX BOARD'S
PROPOSED AMENDMENTS TO SB 1827
As Proposed To Be Amended April 13, 2006

AMENDMENT 1

On page 8, revise lines 1 to 3, as follows:

(c) Notwithstanding subdivision (a), a husband and wife and registered domestic partners, as described in Section 297 of the Family Code, who are registered as domestic partners as of the close of the taxable year, may file separate returns under this part if either spouse or registered domestic partner was either of the following during the taxable year:

AMENDMENT 1A

On page 8, line 17, strike out "or (d)".

AMENDMENT 2

Section 297.5 of the Family Code should be amended as follows:

(g) ~~Notwithstanding this section, in filing their state income tax returns, domestic partners shall use the same filing status as is used on their federal income tax returns, or that would have been used had they filed federal income tax returns.~~ Earned income may not be treated as community property for state income tax purposes.

AMENDMENT 3

On page 8, line 11, strikeout "may" and insert:

shall